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COMPTROLLER

OFFICE OF THE NEW YORK STATE COMPTROLLER

DIVISION OF STATE GOVERNMENT ACCOUNTABILITY

NEW YORK CITY DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT

NEIGHBORHOOD HOMES PROGRAM COMPLIANCE WITH REQUIREMENTS RELATING TO PROFITS ON BUILDING SALES

Report 2006-N-13

AUDIT OBJECTIVE

Our objective was to determine whether the New York City (City) Department of Housing Preservation and Development (Department) collected and deposited its share of profits on buildings sold through the Neighborhood Homes Program (Program).

AUDIT RESULTS - SUMMARY

The Program takes City-repossessed, one- to four-unit residential buildings and sells them for $1 to non-profit housing development companies (sponsors). The sponsors are then required to rehabilitate the buildings and return them to private ownership by selling them to owner-occupants. Many of these sales result in profits to the sponsors, who are generally required to share a portion of their profits with the Department. However, we found that the Department had collected and deposited less than 25 percent of its share of about $1 million in profits owed by certain sponsors.

Sponsors sign agreements setting forth the terms they must abide by in order to purchase Program buildings and receive a Department loan for their rehabilitation. Four of the five sponsors we reviewed were required by their agreements to remit to the Department 25 percent of the profit made on the subsequent sale of the rehabilitated buildings. Had the fifth sponsor been required to remit 25 percent of its profits, we estimate that the Department would have been entitled to about $100,000 from this sponsor during our audit period. [Pages 3-4]

Of the 40 building sales where the 4 sponsors were required to submit a share of the profits to the Department, we found that the profits for only 9 of these sales, totaling $222,500, were actually deposited into Department accounts. The Department had not collected more than $758,000 in profits due from these sponsors for the sale of the other 31 buildings. The sponsors indicated they did not remit the required profits because of cost overruns and taxes owed for buildings under rehabilitation. We saw no evidence that the terms of the agreements were modified to reflect the forgiveness of this major obligation. Additionally, Department officials acknowledged they had not done any audits to verify the sponsors' reasons for retaining the profits. [Pages 4-6]

We found an overall lack of Department control over the accounting for, collection, and deposit of profits owed by sponsors. Furthermore, we are concerned that this lack of control results in a significant risk that other sponsors may owe profits to the Department.

Our report contains five recommendations that the Department should implement to recover profits owed and to institute adequate controls over profits due from Program building sales. Department officials generally agreed with our recommendations and are taking steps to implement changes.

This report, dated September 26, 2007, is available on our website at: http://www.osc.state.ny.us. Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

BACKGROUND

The Department's mission is to maintain and improve the availability, affordability, and quality of housing in the City. The Department works with private, public, and community partners to strengthen neighborhoods and help more New Yorkers to become homeowners or to rent well-maintained, affordable housing.

The Program takes City-repossessed, one- to four-unit residential buildings and sells them for $1 to non-profit sponsoring organizations. These sponsors are then required to rehabilitate the buildings and return them to private ownership by selling them to owner-occupants. To assist with the costs of rehabilitation, the sponsor receives a loan from the Department - generally up to $50,000 per unit - as well as loans from other co-lenders. When the sponsor sells the rehabilitated building, the Department loan is passed on to the homebuyer as a subsidy against the purchase price.

From Program inception in 1998 through December 31, 2006, the Department reported it has transferred 375 buildings to sponsors and provided about $55.9 million in loans to sponsors toward rehabilitation costs. During our audit period, January 1, 2002 through December 31, 2005, Department records indicate that it transferred 209 buildings to 23 sponsors and provided loans totaling $33.4 million. As of July 2006, sponsors had reportedly sold 70 of these buildings to homebuyers; there were sales contracts for another 24 buildings; and rehabilitation had not been completed for the other 115 buildings.

When the Department transfers properties and makes loans to sponsors, both parties sign agreements which describe the property, set sponsor obligations, define procedures if a sponsor defaults, list sample sponsor/homebuyer agreements, and enumerate certain Program requirements. While the Department is not involved in setting the actual sales prices of Program buildings, its agreements with the sponsors limit sales prices to no more than 90 percent of a building's post-rehabilitation market value. Many of these sales result in profits to the sponsors.

AUDIT FINDINGS AND RECOMMENDATIONS

Agreement for the Department to Share in Profits

The six not-for-profit sponsors that bought the most Program buildings during the four-year period ended December 31, 2005 are: Abyssinian Development Corporation (Abyssinian); the Association of Brooklyn Clergy for Community Development, Inc. (ABCCD); BEC New Communities HDFC, Inc. (BEC); Hope Community, Inc. (Hope); Neighborhood Housing Services of New York City, Inc. (NHS); and South Bronx Community Management Company, Inc. (South Bronx). In total, these 6 sponsors purchased 110 buildings and received Department loans totaling $17.5 million. Because of ongoing litigation between the Department and BEC, we did not examine records related to this sponsor's profits. Therefore, we reviewed 84 building purchases with Department loans totaling $14.2 million.

The following table shows the sales and profit activities of the five sponsors we reviewed.

Sales and Profit Activities				
	Number of Buildings			
Sponsor	Purchased	Sold	Sold at a Profit	Total Profit
ABCCD	18	10	9	$ 917,600
Abyssinian	11	4	4	840,000
Hope	14	13	13	1,348,800
NHS	16	16	13	406,400
South Bronx	25	18	14	816,400
Total	84	61	53	$4,329,200

We found that only four of the five sponsors were actually required to remit a portion (25 percent) of the profit on the sale of Program buildings. This requirement is based on these four sponsors' agreements with both the Department and sponsors' co-lender. The fifth sponsor, NHS, which recorded profits on 13 of the 16 buildings it sold, remitted no monies to the Department as it had no legal requirement to do so. Its agreements with both the Department and its co-lender do not require it to share the profit on the sale of Program buildings.

We found the profit-sharing requirement was routinely incorporated in all agreements that involved the Local Initiatives Support Corporation (LISC) as a co-lender. LISC is a non-profit organization that provides construction loans to many of the Program sponsors. However, NHS, which chose another co-lender, was not subject to the profit-sharing requirement. Department officials were unable to explain why the choice of a co-lender should determine whether a sponsor is required to share profits with the Department. Had NHS been subject to the 25-percent profit-sharing requirement, we estimate that the Department would have been due approximately $100,000 from the sale of the NHS buildings during our audit period.

Recommendation

1. Require all sponsor agreements to contain a profit-sharing requirement on the sale of Program buildings.

(Department officials replied that they will work to ensure that the profit-sharing requirement set forth in the Article XVI loan agreement is enforced.)

Auditor's Comment: As our audit found, not all Article XVI loan agreements included a profit-sharing requirement. The Department should require that all sponsor agreements include this requirement and enforce them.

Remitting Profits to the Department

To determine whether the Department is actually receiving its share of the profits on Program home sales, we examined available Department and sponsor records for the four sponsors required to remit a share of their profits.

We found that the Department does not have an adequate system to record, monitor, and account for profits due from the sponsors, and to ensure that profits received are deposited in a timely manner. Instead, the Department relies on the sponsors to calculate and remit the profits due. The four sponsors recorded profits on 40 of the 45 buildings they sold. Based on these records, we determined the Department's share of the profit from these sales totaled almost $1 million. However, according to Department records, only $222,500 in profits - arising from only 9 of these 40 sales - were deposited into Department accounts. Profits from the remaining 31 sales were not deposited into Department accounts, as shown in the following table:

Disposition of Profits				
Sponsor	**Recorded Total Profit**	**Department Share (25 Percent) of Profit**	**Profits Deposited**	**Profits Not Collected**
ABCCD	$ 917,600	$229,400	$ 6,000	$223,400
Abyssinian	840,000	210,000	0	210,000
Hope	1,348,800	337,200	216,500	120,700
South Bronx	816,400	204,100	0	204,100
Total	$3,922,800	$980,700	$222,500	$758,200

We found that Abyssinian did not remit any of the $210,000 in profits due to the Department from the sale of four Program buildings. Abyssinian officials stated that the Department permitted them to retain this money to use for cost overruns related to other buildings. However, Department officials told us they had never given Abyssinian approval to retain any building profits. Department officials did not commit as to whether they would now seek to recover this money.

South Bronx did not remit any of the $204,100 in profits due to the Department from the sale of 14 Program buildings. Sponsor officials stated they needed the money to pay real estate taxes on another building project. Department officials indicated that they had allowed this sponsor to retain these building profits. However, neither the Department nor the sponsor provided any written documentation of this approval, or of the taxes due.

ABCCD retained $223,400 from the Department's share of Program building profits. ABCCD sold nine Program buildings at a profit, as follows:

- In February 2005, ABCCD turned over to the Department $6,000 - the Department's share of the profit on one building.
- ABCCD, in early 2004, sent the Department checks totaling $56,400 representing the Department's share of the profits from two other buildings. We found that in January 2005, the Department returned the checks to ABCCD because it had not deposited this money timely and the checks had expired. The Department asked ABCCD to send replacement checks.
- ABCCD did not remit to the Department $167,000 - 25 percent of the profit on six other Program building sales. Sponsor officials stated that the Department allowed them to retain these funds to cover cost overruns on other sponsor buildings. Department officials acknowledged that it allowed ABCCD to retain this money, as well as the $56,400 from the expired checks noted above, for cost overruns. However, Department officials once again provided no documentation of this approval.

Hope retained $120,700 from the Department's share of Program building profits. Hope sold 13 Program buildings at a profit, as follows:

- Hope turned over to the Department $216,500 - 25 percent of the profit on eight Program buildings.
- Hope sold three other buildings in March 2006, resulting in a profit of $67,800 due to the Department. However, we found that Hope did not transmit these funds to the Department. Hope officials stated they are holding the money in an escrow account to fund cost overruns. While Department officials acknowledge allowing Hope to retain these monies, they did not provide written documentation of this

arrangement. Further, we question the continuing need to hold the monies in escrow. At the time of our review, it had been almost a year since the buildings were sold.

- Hope sent the Department profit checks totaling $52,900 for the sale of two Program buildings in 2004. The Department returned this money to Hope in January 2005, just as it had with ABCCD, because it had not deposited this money timely and the checks had expired. The Department asked the sponsor to send replacement checks. However, Hope officials maintain they subsequently asked and received approval from the Department to retain this money to cover unanticipated cost overruns on construction projects. We saw no written documentation of the Department's approval.

Overall, the Department did not collect more than $758,000 in profits that were due based on agreements between the Department and the four sponsors. We saw no evidence that the terms of these agreements were modified to reflect the forgiveness of this major obligation. We asked Department officials whether they verified the sponsors' needs to retain the profits due the Department. They responded that they had not verified the sponsors' reasons for retaining the profits.

The Department does not have policies and procedures for waiving the profit-sharing requirement. At a minimum, policies and procedures should be in place to address the circumstances under which a waiver may be granted, the necessary documentation, and the level of Department authorization required. Policies and procedures are necessary to ensure waivers are granted in an equitable manner and are consistent with the best interests of the Program.

We conclude the Department needs to institute policies and procedures governing the waiver of profits due from sponsors and to implement adequate internal controls over the collection of profits. Furthermore, the lack of adequate controls leads us to conclude there is a significant risk that other sponsors may not be remitting profits due the Department. In fact, while reviewing Department records regarding the Program, we observed that the Department returned profit checks that it had not cashed to other sponsors in addition to Hope and ABCCD. The Department returned checks to two sponsors totaling almost $64,000, because the checks had expired**.** Therefore, it is incumbent upon the Department to perform a review of all Program building sales to determine whether additional profits are owed by sponsors.

Recommendations

2. Establish policies and procedures addressing the waiver or amendment of the profit-sharing requirement in sponsor agreements. These should include documentation and authorization requirements.

(Department officials replied that there are now formal procedures in place that require a complete accounting of cost, including profit/loss and the Department's share of any profit. These procedures also require that a request to waive the profit-sharing requirement, and the Department's response to that request, be in writing.)

3. Establish fiscal controls for recording, monitoring, accounting for, and depositing the Department's share of profits owed by sponsors.

(Department officials responded that they will further strengthen their operations by documenting receipt of all profit shares and will promptly deliver checks to the Department's Fiscal Department for deposit.)

4. Review the $758,200 in uncollected profits we identified and seek recovery, where appropriate. Document reasons for not recovering any portion of these profits.

(Department officials responded that they have reviewed the $758,000 in uncollected profit and determined that it is not feasible to collect these funds from sponsors.)

5. Review all sales of Program buildings to date to determine whether sponsors submitted profits due, and seek recoveries where appropriate. Document any reasons for not recovering profits required to be remitted.

(Department officials responded that a review of the sales for the sponsors identified in the audit period had indicated that additional administrative costs were identified by the sponsor and were verbally approved by the lender and the Department as allowable expenditures.)

AUDIT SCOPE AND METHODOLOGY

We conducted our audit in accordance with generally accepted government auditing standards. We audited sponsor compliance with requirements relating to profits on Program building sales for buildings transferred to selected sponsors during the period January 1, 2002 through December 31, 2005. Our review covered transactions through February 2007 relating to profit collections and deposits for building sales. To accomplish our objective, we reviewed the LISC Manual and Department and sponsor agreements and records. We also interviewed Department, sponsor, and LISC officials.

To determine whether sponsors comply with building profit requirements, we examined the treatment of building profits for five of the six sponsors that bought the most Program buildings during the period January 1, 2002 through December 31, 2005. Because the largest sponsor, BEC, was engaged in legal proceedings with the Department at the time of our audit, we excluded this sponsor from our audit testing.

As is our practice, we notify agency officials at the outset of each audit that we will be requesting a representation letter in which agency management provides assurances, to the best of their knowledge, concerning the relevance, accuracy and competence of the evidence provided to the auditors during the course of the audit. The representation letter is intended to confirm oral representations made to the auditors and to reduce the likelihood of misunderstandings. In the representation letter, agency officials assert that, to the best of their knowledge, all relevant financial and programmatic records and related data have been provided to the auditors. Agency officials further affirm that either the agency has complied with all laws, rules, and regulations applicable to its operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors. However, officials at the New York City Mayor's Office of Operations have informed us that, as a matter of policy, mayoral agency officials do not provide representation letters in connection with our audits. As a result, we lack assurance from agency officials that all relevant information was provided to us during the audit.

In addition to being the State Auditor, the Comptroller performs certain other

constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

AUTHORITY

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article III of the General Municipal Law.

REPORTING REQUIREMENTS

Draft copies of this report were provided to Department officials for their review and comment. We considered their comments in preparing this report. A copy of the Department's response is included as Appendix A.

Within 90 days of the final release of this report, we request that the Commissioner of the New York City Department of Housing Preservation and Development report to the State Comptroller, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

CONTRIBUTORS TO THE REPORT

Major contributors to this report include Frank Houston, Cindi Frieder, Gene Brenenson, Alina Mattie, Kamal Elsayed, Jay Gwak, Daniel Raczynski, Elizabeth Norniella, and Paul Bachman.

APPENDIX A - AUDITEE RESPONSE

City of New York
DEPARTMENT OF
HOUSING PRESERVATION AND DEVELOPMENT
100 GOLD STREET, NEW YORK, N.Y. 10038
nyc.gov/hpd

SHAUN DONOVAN
Commissioner

August 10, 2007

Frank Houston
Audit Director
Office of the State Comptroller
Division of State Government Accountability
123 William Street - 21 Floor
New York, New York 10038

Re: Audit of the Neighborhood Homes Program Compliance with Requirements Relating to Profits on Building Sales
Audit Number: 2006-N-13

Dear Mr. Houston:

The following represents the Department of Housing Preservation and Development's response to the recommendations contained in your audit of the Neighborhood Homes Program Compliance with Requirements Relating to Profits on Building Sales

If you have any additional questions, please call Deputy Commissioner Bernard Schwarz at 863-6610.

Thank you.

Sincerely,

Shaun Donovan

(212) 863-6100 FAX (212) 863-6302 TTY (212) 863-8508

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AUDIT RESPONSE
NEW YORK STATE COMPTROLLERS AUDIT
NEW YORK CITY DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT
NEIGHBORHOOD HOMES PROGRAM COMPLIANCE WITH REQUIREMENTS RELATING TO PROFITS ON BUILDING SALES
REPORT 2006-N-13

Finding		
Agreement for the Department to Share in Profits	Recommendation 1. Require all sponsor agreements to contain a profit-sharing requirement on the sale of Program buildings.	**Response 1.** Moving forward, HPD will work to ensure that the profit sharing requirement set forth in the NHP Article XVI agreement is enforced.
Remitting Profits to the Department	Recommendation 2. Establish policies and procedures addressing the waiver or amendment of the profit-sharing requirement in sponsor agreements. These should include documentation and authorization requirements.	**Response 2.** Currently there are formal procedures in place for review and approval of sponsor payment requisitions. In addition to these procedures HPD will require that sponsors, in conjunction with their lenders, provide a complete accounting of total project costs. This accounting analysis will include: total project costs by category; total funding sources (HPD loan, private [LISC, Enterprise or bank] loan, equity); sales price; lender release price; total profit/loss; and HPD's share of any profit. Once HPD reviews this information, we will respond to a sponsor's request to waive the profit-sharing requirement. We will require that such a request is made in writing and our response will be provided in writing. Certain circumstances would have to be present for HPD to approve a waiver, such as project cost overruns beyond the control of the sponsor. HPD's authorization could cover some or the entire 25% profit share otherwise due to the agency.
	Recommendation 3. Establish fiscal controls for recording, monitoring, accounting for, and depositing the Department's share of profits owed by sponsors.	**Response 3.** NHP program staff will further strengthen their operations by documenting receipt of all profit shares and will promptly deliver checks to HPD's Fiscal Department for deposit. Fiscal Accounts Receivable (AR) receives checks and money orders two ways: via hand delivery from internal divisions (checks and money orders cannot be sent through inter-office mail or left on a staff person's desk in their absence) and by mail from mortgagors.

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For internal receipts, a transmittal cover sheet is attached which states the appropriate budget codes, descriptions, number of checks and dollar amounts. For the internal receipts, the cover sheet is clocked in and signed by this receipt clerk who then makes a copy of the sheet and the checks. The original sheet is returned to the person delivering the checks. Checks that are received by mail are copied and clocked in. Appropriate account numbers and budget codes are identified.

In most cases checks received are already endorsed, but if they are not they are endorsed immediately upon receipt by AR.

Before proceeding with the deposit function, checks are classified into two categories: mortgage collections and all other checks. After determining the type of payment, the checks are logged with the required data related to each type of check or money order into the Access Check Receipts Entry (CRE) tracking system). After all checks have been recorded a unique system generated CRE number is created for each deposit. Cash receipts reports are created for each individual budget code as well as a summary report for each unit.

Accountants reconcile and verify all system-generated cash receipts to actual checks, deposit tickets are completed and the number of the final CRE is written on the back of each check for future identification. The accountant approves the CRE as preparer and a supervisor or senior accountant co-signs as reviewer. A designated employee then takes the checks to the bank to be deposited. Through-out the process, segregation of duties is strictly maintained.

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The data contained in each CRE are exported electronically to City's Financial Management System (FMS) on a daily basis so as to update all budget codes. Month reconciliations are completed to ensure that the exports were received and properly updated by FMS.

As per Directive 11, all checks and money orders are deposited on the day of receipt unless they arrive after the day's deposit has been taken to the bank. If a check is restrictively endorsed or received too late to be included in the daily deposit, it is kept in the safe for inclusion in the next deposit. Prompt receipt and processing of the checks and money orders decreases the possibility of checks or money orders being lost or misplaced and/or becoming stale dated. The Assistant Commissioner of Fiscal periodically sends out a reminder notice stating the check handling requirements.

Recommendation 4.
Review the $758,200 in uncollected profits we identified and seek recovery, where appropriate. Document reasons for not recovering any portion of these profits.

Response 4. HPD has reviewed the $758,000 in uncollected profit and determined that it is not feasible to collect these funds from sponsors. Each sponsor had been given verbal authorization to use the funds to offset cost overruns that occurred during the term of the project. Moving forward, however, HPD will have sponsors submit complete project summaries (as described above) and written requests for use of HPD's profit share. HPD will review all documentation received and make a determination. Unless written authorization to retain HPD's profit share is received, we will expect sponsors to remit HPD's share in a timely fashion.

Recommendation 5.
Review all sales of Program buildings to date to determine whether sponsors submitted profits due and seek

Response 5. The review of the sales for the sponsors identified in the audit period has indicated that additional administrative costs above and beyond the cost to renovate the buildings were identified by the sponsor and

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recoveries where appropriate. Document any reasons for not recovering profits required to be remitted.	verbally approved by the lender and HPD as allowable expenditures. Administrative costs included homeowner training conducted by the sponsors, salaries for project management/relocation staff and deferred overhead. It should be noted that the Department has requested information from the lender and the respective sponsors to provide supportive documentation for these costs. Furthermore as projects reach completion HPD will work with sponsors to determine if all profit due to the agency was received and, where appropriate, recover funds not submitted to date. In cases where recovery is not envisioned, we will document that decision in our files and in written form to sponsors. The accounting information to be provided by sponsors will be reviewed by our co-lenders (LISC/Enterprise) to ensure accuracy.

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